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C O N F I D E N T I A L SECTION 01 OF 02 SANAA 001361

SIPDIS

PLEASE PASS TO DEPARTMENT OF TREASURY FOR G. MULLINAX

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SUBJECT: AGRICULTURAL BANK ABANDONS CORRUPT PAST, LOOKS TO PROFITABLE FUTURE

REF: SANAA 328

Classified By: Ambassador Thomas C. Krajeski for reasons 1.4 b and d.

1. (SBU) Summary. The Yemen Cooperative and Agricultural Credit Bank (CACB) is moving away from a history of corruption and poor banking practices and positioning itself as a viable commercial bank. The MEPI-funded Financial Services Volunteer Corps worked with the bank May 14-18 to craft a proposal for restructuring. The program will be funded primarily by USDA PL480 funds. Bank Chairman Moayed is an impressive reformer with political ambitions. He has made progress in cleaning up the bank, but long-term changes require a comprehensive restructuring effort that includes professional management and banking practices. As one of the few institutions able to make small loans to farmers, the bank plays a key role in rural development and is strongly supported by USAID. Although Moayed is clearly moving in the right direction, the CACB is still state owned and must overcome a number of political obstacles on its way to commercial stability and profitability. End summary.

FSVC is the Doctor, Ag Bank the Patient

2. (U) The Cooperative and Agricultural Credit Bank (CACB) took its first steps towards restructuring on May 14, with a week long visit from the Financial Services Volunteer Corps (FSVC). Funded by MEPI, FSVC specialists Geoffrey Milton and Alan Deines visited Yemen to offer technical advice and help develop a restructuring strategy. The volunteers' trip objective was to develop a targeted proposal to solicit bids from consulting companies. In FSVC's view, it was essential that the RFP fall within the CACB's budget and meet the criteria of both the bank and the Mission.

3. (C) The CACB is one of four government-owned banks and, until recently, functioned as a conduit for ROYG grants to agricultural and military interests, under direction from the Ministry of Agriculture. According to FSVC, "the bank has suffered from inadequate management and operated at the whim of local political forces." The chairman himself, Hafedh Moayed, admits that the accounts were rife with corruption, saying that any CACB financial statements from before the beginning of his tenure in 2004 are essentially worthless. Many bad loans remain on the books, and it is unclear if the ROYG will absorb these losses or force the bank to cover them with earnings. The CACB only received a full banking license from the ROYG in 2004, and is now looking to become a universal bank with the full range of banking services. "You are the doctor," said Moayed to the volunteers, "and we are the sick patient. You are here to cure us."

4. (SBU) In the volunteers' view, Moayed represents a new era for the CACB. The Chairman has a strong reputation as a reformer from his days as Customs Director, and was appointed to his current position with a mandate to modernize and improve the bank's operations (reftel). FSVC believes that Moayed's long-term goal is to privatize the bank and manage it according to international standards. In the short run, the Chairman has revised the lending strategy to balance small and big loans and increase the returns on both. He is also determined to conduct the restructuring bid according to international standards. Nevertheless, FSVC identified many daunting challenges that remain in reshaping the CACB. The RFP outlines necessary reforms in staffing, organizational structure, capital reserves, earnings, risk management, IT, and the lending function.

CACB Shows Promise, Needs to Clean House

5. (C) Milton and Deines agreed that many of the bank's 1200 employees are relics of the political past with few real banking skills. This includes the bank's current Managing Director, Yahya Sabri, who was appointed to the CACB by the President over twenty years ago and has no clear function. Many other departments need extensive training if they are to perform essential functions in lending and risk management. (Note: The CACB's efficient international banking department is an exception to this rule, and is led by a professional

banker hired from Dubai. End note.) Before Moayed's tenure, a restructuring effort funded by the Embassy of the Netherlands ran aground when it recommended firing high level staff. FSVC did not repeat this mistake, but did recommend hiring professional banking specialists as General Managers and extensive retraining for the existing staff. Moayed received these recommendations well, and immediately tried to hire an executive from the International Bank of Yemen as CACB General Manager for banking.

16. (SBU) Despite the many challenges, there are a number of promising signs at the CACB. In 2004, the ROYG agreed to increase the CACB's capital to six billion Yemeni Riyals (31.4 million USD) by 2007, through conversion of long-term debt previously owed to Yemeni government bodies. The Central Bank, which pays almost all public employee salaries directly, recently decided to issue teachers' salaries at the Amran branch of the CACB. With 35 branches and four under construction, the CACB is the only bank in Yemen that is truly national. To link this system electronically, the bank recently embarked on IT overhaul, funded by the Arab Monetary Fund.

USAID and Agricultural Banking

17. (U) Agricultural investment is essential to Yemen's development, but there are few mechanisms for lending to small farmers. (Note: Approximately eighty percent of Yemenis derive their income from agriculture. End note.) Commercial banks are reticent to issue loans to unfamiliar borrowers. Without strong rule of law and with traditional Islamic opposition to interest charges, every loan in Yemen is high risk. Agricultural loans present specific challenges, as the average loan processing period is six to nine months-- too long to accommodate a crop cycle. With its national bank network and dedicated agricultural lending funds from the ROYG, the CACB is a natural partner for USAID agriculture programs. As such, FSVC's report maintained rural development as a key part of the bank's business, recommending the bank hire a professional manager for agricultural banking. The report also stressed the importance of strengthening Yemen's legal infrastructure to support sound lending practices, and technical assistance and training for customers emphasizing their responsibility to repay loans. For these efforts to succeed, however, the CACB must be a functional and reliable banking institution.

More Work to be Done

18. (SBU) Following FSVC's formal report to the CACB, some steps will remain before the RFP can be submitted. FSVC agreed to check with advisors to make sure the tendering document follows proper legal standards. The volunteers requested that USAID share the document with contractors to determine if the restructuring project will fall within the proposed budget. Once the bids are received, the CACB will likely require additional guidance in the selection process and in managing the role of the consultant in the restructuring process. FSVC suggested that there may be available funds in the future to continue working with the bank.

Main Challenge is Political

19. (C) Comment: The success of the restructuring plan proposed by FSVC depends largely on political factors. Chairman Moayed is an energetic leader who has already made impressive reforms at the CACB, but he is a politician and not a banker. There are persistent rumors that Moayed will be promoted to head of the Yemen Central Bank in a Cabinet reshuffle (reftel). This could be good news for Yemen, but could also undo the progress Moayed has made at the CACB. It is essential that the Chairman hire and empower banking professionals who can carry on reforms once he has departed. Political problems also have the potential to plague the restructuring bid itself. Despite FSVC's light touch, it is clear that running a profitable bank will require layoffs of ineffective staff, some of whom have strong political protection. If you want to gauge Moayed's commitment to this process, said Deines, tell him to fire the Managing Director. It also remains unclear whether the RFP must be submitted to the ROYG's High Tendering Committee, which lacks both transparency and credibility. FSVC and the bank agreed that it would be preferable if they evaluated the bids directly, with the guidance of the Mission. In general, Moayed's goal is to distance the CACB from the ROYG, and allow a professional banking system based on the bottom line. Preventing ROYG meddling will be a test of Moayed's rising star. End comment.
Krajewski